

How to Profit From Six 'Sizzling' Markets

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In this increasingly global economy, the question of whether to invest overseas is a no-brainer. But how much should you invest in emerging countries, those fledgling economies that have churned out supercharged returns (and volatility) over the past few years? Pran Tiku, president of Peak Financial Management in Waltham, Mass., and author of *Six Sizzling Markets: How to Profit From Investing in Brazil, Russia, India, China, South Korea, and Mexico*, says long-term investors should devote 10 to 15 percent of their stock portfolio to emerging markets (with the bulk of that focused on the "sizzling six"). Tiku recently spoke with *U.S. News*. Excerpts:



Pran Tiku

In a sentence, how would you summarize the thrust of your book?

There is a dynamic shift occurring in emerging markets that will spur growth in one shape or form for potentially the next half century.

Most people have heard the case for growth in the "BRIC" countries—Brazil, Russia, India, and China. Why do you consider Mexico and South Korea "sizzling markets"?

Mexico and South Korea don't get enough credit. They are slightly ahead of the BRIC countries in terms of political and economic stability. And look at their dynamics. In terms of population, South Korea is the 10th-largest country in the world and has gained 7.3 percent, on average, since 1998. Going forward, its growth rate is projected to be at least about 5 percent. Compared with the developed world, which is growing at 1 percent to 3 percent, that's remarkable.

Also, as China's neighbor, South Korea has a major edge in terms of infrastructure and technology. It's replacing Japan as a technology partner. For example, Hyundai and Samsung are replacing many of the old-line Japanese companies that used to have an edge in technology. South Korea is also the strongest of the six countries in terms of corporate governance and political stability. Consider the recent resignation of the chairman and vice chairman of Samsung Electronics after alleged tax evasion and breach of trust. That's an example of the country's regulatory environment at work.

Mexico, the 11th-largest country in terms of population, will continue to benefit from NAFTA. But it

has also been decreasing its reliance on the U.S. by diversifying exports. Fitch recently reported that credit ratings within the Mexican economy have been diverging from other Latin American rivals' due to strengthened balance sheets, lower government debt, higher commodity prices, and an appreciated currency versus the U.S. dollar. Mexico is producing industry leaders like América Móvil, which continues to build a footprint in Latin America, and cement giant Cemex, which is expanding globally, taking market share, and even buying companies in Europe.

What's making these countries sizzle?

One thing is strong demographics. With the exception of Russia—which has a declining population—all of these countries have a built-in demographic dividend, meaning the younger populations will continue to drive growth. There's also technology. These countries started from a low base but are leapfrogging in technology. They don't need to put out expensive land lines—instead they're leaping into satellites and cable. They're bypassing the traditional technology route for a more advanced route, whether it's fiber optic, digital, or satellite communications.

Education will also propel them forward. All of these countries have come to believe that their continued growth will depend on their ability to educate the masses. In India, they are starting from primary levels in remote parts of the country. The agrarian state of Kerala has achieved a virtual 100 percent literacy rate (adult literacy in India is now about 61 percent and rising fast). This is just an example of how seriously they're taking education. More engineers are graduating from college in India than in the United States. Literacy is also growing in China, where rates are currently about 91 percent. Russia is emphasizing technology as well as education.

How inviting are these markets to foreign investors?

At one time, if you wanted to invest in these countries, you couldn't know who was controlling the companies. Now, many of the larger companies trade on exchanges in the U.S., such as Vimpel, a major cellphone operator in Russia, and Infosys, one of the largest technology companies in India. The corporate governance and accounting standards of many of these companies now match multinationals of developed economies. These are not isolated examples. To be listed in the U.S., these companies must follow the mandates of the Securities and Exchange Commission, which makes it necessary to be transparent. That, in turn, is creating a model for other countries to become equally transparent.

All six countries are becoming aware that in order to sustain growth, they will need to participate in open trade regimes. They're making huge advances by engaging in trade pacts and tearing down barriers to open trade. India began opening up its economy in the early '90s, and China has been on this path now for over two decades. The restrictions that still remain are those that governments feel will hurt nascent industries that are so far unable to compete.

No opening is perfect—there are still enclaves of politically powerful interests in each country that continue to be shielded, such as financial services in India, China, and Russia. However, these countries will continue to make deals on trade barriers and tariffs in order to facilitate the transfer of skills and capital.

What's the best way to invest?

For the retail investor, there are three products that offer exposure to these countries: ADRs, which are foreign companies that trade on U.S. exchanges; exchange-traded funds; and mutual funds. The easiest and cheapest option is exchange-traded funds, which give you an instantly diversified portfolio of stocks within each country. ETFs are available for all six countries. Although no fund invests in all six, you can buy a BRIC ETF, such as BLDRs Emerging Markets Index (symbol ADRE), iShares MSCI BRIC Index (BKF), and SPDR S&P BRIC Index (BIK).

Could any of these countries be considered "emerged" rather than "emerging"?

All six countries are breaking the chains of the "emerging" label on the political and governance front. Each country is working to improve its infrastructure, workforce, technology, and regulatory environment, which consequently increases foreign investors' confidence. South Korea is considered the most "emerged" country, because it has progressed the most in imitating the political, economic, and social environment of developed nations.

What could go wrong with China?

Nobody is doubting China's ability to continue to grow—even the most pessimistic economists are putting the growth rate at a minimal 7 percent, and I've seen rates as high as 10 to 11 percent. China is on an upturn. The major concern, however, is its ability to curb inflation. Food and energy prices continue to skyrocket and can have a negative impact on China's domestic economy and growing labor force. If inflation persists at its current annualized rate of 8.7 percent, the country's real rate of growth will suffer.

It's a long-term story for all of these countries. If there is going to be subpar growth, it's going to be in [areas] like the U.S., Europe, and Japan, where infrastructure isn't being built and everybody has a cellphone. Will stock markets overheat? Absolutely, but if you really look at where these economies are heading, you've got some exciting opportunities.

How risky are these markets versus, say, five years ago?

The short answer is: less risky. In years past, they have been hot and cold based on limited market exposure to the outside world. Now it's a global market, and these countries have more stability than a lot of people think. Recently, China's stock market was down 20 percent from its peak. That's a lot, but when you consider that China's FTSE/Xinhua index has doubled on an annual basis over the last three years, it doesn't seem so bad. In the past, you might have had that growth but with a drop of 100

percent.

Investors must understand that this is a long-term story and that there will be volatility. It's foolhardy for people to think these markets are of the same quality and stability of, say, developed markets like America and Europe. They'll continue to have ups and downs with economic and political changes, but the drops will be fewer and further between.

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